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January 30, 2004

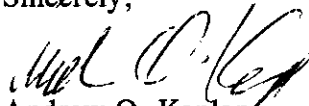
Hon. Marlene H. Dortch
Office of the Secretary
Federal Communications Commission
445 12th Street, SW, Suite TW-A325
Washington, D.C. 20554

Re: Comments of the Commonwealth of Massachusetts Department of Telecommunications and Energy in the Matter of the Review of the Commission's Rules Regarding the Pricing of Unbundled Network Elements and the Resale of Service by Incumbent Local Exchange Carriers, WC Docket No. 03-173, FCC 03-224

Dear Secretary Dortch:

For filing, attached please find the Reply Comments of the Massachusetts Department of Telecommunications and Energy in the above-referenced matter in response to the Commission's Notice of Proposed Rulemaking, released September 15, 2003 and published in the October 17, 2003 Federal Register. Additionally, the Comments are being filed electronically through ECFS.

Sincerely,


Andrew O. Kaplan
General Counsel

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**BEFORE THE
FEDERAL COMMUNICATIONS COMMISSION
WASHINGTON, D.C. 20554**

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In the Matter of)
)
Review of the Commission's Rules Regarding the Pricing) WC Docket No. 03-173
of Unbundled Network Elements and the Resale of Service)
by Incumbent Local Exchange Carriers)

**REPLY COMMENTS OF THE MASSACHUSETTS
DEPARTMENT OF TELECOMMUNICATIONS AND ENERGY**

Dated: January 30, 2004

**BEFORE THE
FEDERAL COMMUNICATIONS COMMISSION
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DEPARTMENT OF TELECOMMUNICATIONS AND ENERGY**

SUMMARY

The Massachusetts Department of Telecommunications and Energy ("MDTE") hereby submits these reply comments pursuant to the Federal Communications Commission's ("FCC" or "Commission") Notice of Proposed Rulemaking ("NPRM")¹, issued September 15, 2003 in WC Docket No. 03-173 and published in the October 17, 2003 Federal Register, and in response to the initial comments on the proposed rulemaking submitted on or before December 16, 2003. The NPRM reexamines the Total Element Long Run Incremental Cost ("TELRIC") pricing methodology for unbundled network elements ("UNEs") and resold

¹ Review of the Commission's Rules Regarding the Pricing of Unbundled Network Elements and the Resale of Service by Incumbent Local Exchange Carriers, WC Docket No. 03-173, FCC 03-224, Notice of Proposed Rulemaking (rel. September 15, 2003).

telecommunications services that incumbent local exchange carriers ("ILECs") must make available to competitive local exchange carriers ("CLECs") pursuant to the Telecommunications Act of 1996 ("Telecommunications Act") and the FCC's 1996 Local Competition Order.²

In these reply comments, the MDTE argues that the Commission's existing TELRIC rules should be modified to account for ILECs' actual forward-looking costs so that all carriers are given the appropriate pricing signals for making efficient network investments and to better reflect the true cost to ILECs of leasing UNEs. In addition, the MDTE offers recommendations regarding the "Implementation Issues" discussed in the NPRM, suggesting that the FCC should give state commissions flexibility in implementing the new pricing rules to be adopted in this proceeding, particularly to those states that have just completed UNE cases or will complete them prior to the adoption of the new rules.

² Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, CC Docket No. 96-98, First Report and Order, FCC 96-325 (rel. August 8, 1996) ("Local Competition Order").

I. INTRODUCTION

The FCC stated that the purpose of the NPRM is to determine whether the Commission's UNE pricing rules are working as intended; that is, whether the rules are sending the appropriate economic signals to carriers in order to promote efficient facilities investment. NPRM at ¶¶ 2-3.³ The current TELRIC model is designed to calculate the costs for the most efficient carrier to construct instantaneously an ubiquitous network from scratch to serve all customers in the ILEC's service territory. Id. at ¶ 49. The FCC recognized that "[i]n the real world, however, even in extremely competitive markets, firms do not instantaneously replace all of their facilities with every improvement in technology." Id. at ¶ 50. Thus, the FCC tentatively concluded that it should modify the TELRIC rules to adopt "an approach that bases UNE prices on a cost inquiry that is more firmly rooted in the real world attributes of the existing network, rather than the speculative attributes of a purely hypothetical network." Id. at ¶¶ 4, 52. In particular, the FCC asked if TELRIC rules should be based on the ILEC's "actual network topography and currently available, forward-looking technologies" or one that is based on a LEC's planned upgrades to the network over a objective planning horizon. Id. at ¶¶ 53, 54.

³ In the Local Competition Order, the Commission established two goals for UNE pricing: (1) to provide "efficient entry and investment signals" to carriers; and (2) to allow ILECs to recover the forward-looking costs of leasing network elements. NPRM at ¶ 38, citing Local Competition Order at ¶ 672.

The MDTE submits these reply comments based on the lessons learned in UNE ratemaking in Massachusetts. The MDTE has conducted two UNE rates cases since the FCC issued the Local Competition Order in 1996. The MDTE first established UNE rates in its Consolidated Arbitrations proceeding (a joint arbitration for five CLECs and Verizon⁴), begun in 1996. Consolidated Arbitrations, D.P.U. 96-73/74, 96-75, 96-80/81, 96-83, 96-94 (1996). Most recently, the MDTE completed its second review of rates, UNE Rates, D.T.E. 01-20 Part A, in July 2003, after a two-and-a-half year investigation.⁵ This proceeding was an

⁴ Verizon New England, Inc. operates in Massachusetts as Verizon Massachusetts.

⁵ The MDTE opened D.T.E. 01-20 on January 12, 2001. The primary portion of investigation was concluded on July 11, 2002, when the Department issued its determinations on the appropriate models, inputs, assumptions, and other related issues, and required Verizon to make a compliance filing that calculated the new rates. D.T.E. 01-20-Part A Order (July 11, 2002). Receipt of the compliance filing was delayed to allow the MDTE to address motions for reconsideration and clarification, which involved taking additional evidence on certain issues. Subsequently, the MDTE issued order D.T.E. 01-20-Part A-A (January 14, 2003) deciding the motions for reconsideration and clarification. On February 13, 2003, Verizon submitted its compliance filing. Upon review of the compliance filing and parties' comments, the Department issued order D.T.E. 01-20-Part A-B (May 29, 2003), in which it approved, in part, and rejected in part, the compliance filing and directed Verizon to re-file it with certain corrections and revisions. Verizon submitted a revised compliance filing on June 12, 2003, and, in response to comments regarding the revised compliance filing, submitted a supplement on July 2, 2003. On July 14, 2003, the MDTE issued a Letter Order approving, in part, and denying, in part, Verizon's re-compliance filing and ordering Verizon to file final corrected tariff pages. Upon receipt on July 16, 2003, the MDTE stamp-approved Verizon's final compliance filing. On August 6, 2003, the MDTE issued another Letter Order denying a July 18, 2003 motion for reconsideration concerning a non-rate issue. The MDTE is currently evaluating a motion to reopen the proceeding to receive additional evidence and argument.

exhaustive, comprehensive investigation of all of Verizon's UNE and interconnection pricing, including recurring, non-recurring, and collocation rates.

II. RECOMMENDATIONS

A. Network Assumptions

The MDTE agrees with those commenters in this proceeding who contend that the TELRIC rules require modification.⁶ See, e.g., Comments of the Verizon Telephone Companies at 3 (December 16, 2003). In particular, the MDTE supports the FCC's tentative conclusion that the TELRIC rules be based more on the real-world attributes of ILECs' existing networks rather than on a network of a hypothetical, most efficient carrier. The MDTE agrees with commenters who urge the FCC to base UNE rates on, or close to, ILECs' actual forward-looking costs. In so doing, the FCC will achieve its goals of promoting efficient investment in network facilities by all competitors and ensuring that ILECs can recover the reasonable costs of leasing UNEs.

As noted in certain comments, the FCC's TELRIC rules, by basing costs on the hypothetical most efficient carrier, expect a level of efficiency that no ILEC – or CLEC, for that matter – can attain. Id. The commenters make this point, and it is one the FCC should consider seriously. In addition, as pointed out by certain commenters, the hypothetical most efficient carrier construct requires excessive speculation on the part of regulators regarding the

⁶ These Reply Comments are not intended to indicate agreement or disagreement with the pending motion to reopen the record in MDTE docket 01-20 Part A.

cost components of UNE rates, which in turn can over-complicate the rate-setting process.⁷

Id. at 7-8.

The MDTE agrees with certain commenters that because of the nature of the existing TELRIC rules, carriers (both ILECs and CLECs) are deprived of proper pricing signals to make sound business decisions, including decisions with regard to investing in their networks. See, e.g., id. at 25-26. If UNE rates are set below cost, CLECs may have the incentive to over-rely on UNEs and under-invest in their own facilities. ILECs also may have a disincentive to invest in their networks because of under-recovery of their legitimate wholesale costs.

The MDTE agrees with commenters who suggest that the way for the FCC to correct these problems and achieve its goal of providing the proper economic incentives to promote network investment is to modify the TELRIC rules so that they are based on, or more closely resemble, an ILEC's actual long-run forward-looking costs, not the forward-looking costs of the hypothetical most efficient carrier. This can be done, as the FCC proposed and certain commenters advocate, by basing the network inputs and assumptions (e.g., the mix of technology, fill factors, etc.) that underlie the TELRIC rules on the ILEC's actual network

⁷ As some commenters note, the speculative nature of the FCC's TELRIC rules has had the unintended consequence of leading to significantly different results in different states, results that cannot be explained by actual cost differences. See, e.g., Comments of the Verizon Telephone Companies at 7. That is not to say that state commissions have applied the TELRIC formula incorrectly or developed incorrect rates, because given the extremely speculative nature of TELRIC, a wide spectrum of rates can result from its correct application.

design and attributes. Id.; NPRM at 4. In addition, an approach that is representative of an ILEC's actual long-run forward-looking costs would not burden CLECs with historical investment inefficiencies, because UNE rates would be based on only an ILEC's forward-looking investment upgrades.

Setting UNE prices based on, or closer to, an ILEC's actual forward-looking costs will send the proper economic signals to CLECs, because, to the extent that they can provide service more efficiently using alternative facilities or technologies, they will have an economic incentive to do so. Prices developed with reference to ILECs' actual forward-looking costs will also provide ILECs the appropriate economic incentives to invest in their networks. Further, correct pricing of UNEs will simplify the debate over access to UNEs and UNE-P. As long as UNEs are priced properly – i.e., so that ILECs recover the actual forward-looking costs of those elements, including a reasonable share of joint and common costs – then ILECs and CLECs will receive the proper economic signals and can compete based on the relative efficiency of their retail operations. See Review of Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers, CC Docket No. 01-338 (FCC Triennial Review Further Notice of Proposed Rulemaking), MDTE Initial Comments at 6-7 (March 14, 2002).

The modifications to the FCC's TELRIC rules suggested above could lead to increases in UNE rates. However, such increases need not impede competition, where that competition is based on leasing of UNEs. Increased UNE rates could make it more difficult for CLECs to compete if they "squeeze" the margin between wholesale and retail rates. In such situations, it

is incumbent upon state commissions to re-balance retail rates and/or adopt a competitively neutral funding mechanism to address the price squeeze. See Investigation into IntraLATA and Local Exchange Competition in Massachusetts, D.P.U. 94-185-D at 9 (1998) (MDTE noted that a competitively-neutral universal service funding ("USF") mechanism could address the problems created by the interrelationship between cost-based wholesale rates and non-cost based retail rates); see also Verizon Alternative Regulation Plan, D.T.E. 01-31-Phase II at 83 (2003) (MDTE recognized the potential for arbitrage opportunities and price squeeze problems caused by deaveraged wholesale prices and averaged retail prices for residential customers and stated that it may consider the adoption of a USF mechanism to address these problems). In Massachusetts, the MDTE has re-balanced Verizon's retail rates twice: once in the early 1990s as part of a multi-year process that increased the dialtone line rate from \$1.19 to \$9.91; and again in 2003, in a docket to adopt an alternative regulation plan for Verizon, in which the dialtone line rate was increased to \$12.36. See New England Telephone and Telegraph Company, D.P.U. 89-300, at 82-87 (1990); New England Telephone and Telegraph Company, D.P.U. 93-125, at 20 (1994); D.T.E. 01-31-Phase II at 79. Below-cost retail rates can be a significant obstacle to local competition.

B. Implementation Issues

In the NPRM, the FCC sought comment on whether to require states to implement its new UNE pricing rules in accord with a national deadline. NPRM at ¶¶ 149-151. The MDTE agrees with the New York Department of Public Service that the FCC should grant states flexibility in implementing the new pricing rules. See Comments of New York State Department of Public Service at 13-14 (December 16, 2003). As the FCC is aware, state commissions and parties to their proceedings must devote significant resources to UNE rate cases, and these proceedings often take several years to complete. See NPRM at ¶ 6. In Massachusetts, the MDTE completed its second UNE rates case less than a year ago (in July 2003), 30 months after opening the investigation. That case was undertaken pursuant to a five-year review schedule the MDTE established for UNE rates in Massachusetts upon completion of its first UNE rates proceeding.⁸ Upon conclusion of D.T.E. 01-20-Part A, the MDTE stated that its next UNE rates review would not begin until March 2006 in accordance with the existing five-year review schedule.⁹ D.T.E. 01-20-Part A-B Order at 63. To require the MDTE and other state commissions that have recently completed UNE rates cases (or have

⁸ See Investigation of Resale Tariff of Bell Atlantic, D.T.E. 98-15-Phases II/III at 15-17 (1999).

⁹ The MDTE ordered that the new rates it approved in July 2003 would be retroactive to August 2002 (to reflect a one-year delay for compliance issues and the resolution of motions for reconsideration and clarification) and would remain in effect for five years, until August 2007. The March 2006 date was selected to allow at least 18 months for the Department to complete the next UNE rates review before August 2007.

UNE rates cases pending) to immediately undertake another UNE rates review would be a significant hardship, not only for the commissions, but also for carriers that participate in the UNE rates proceedings. Moreover, it is difficult for both ILECs and CLECs to determine their business plans if UNE rates are continually under review and may change. Therefore, the MDTE recommends that the FCC not establish a national timetable for implementation of its new rules. However, in the alternative, should the FCC establish such a timetable, the MDTE believes that it would be useful for the FCC to adopt a grace period for states that have recently established new UNE rates prior to adoption of the FCC's new TELRIC rules, in order to promote rate stability and limit the type of resource-intensive litigation that we discuss above. While the appropriate length of any national grace period may depend in part on the individual UNE rates review cycles of different states, the MDTE offers the following suggestions based on circumstances in Massachusetts. The MDTE's existing UNE rates review schedule contemplates that the MDTE and carriers in Massachusetts will have roughly a three-year reprieve before having to begin a new UNE case (and, assuming 18 months to complete a new UNE case, five years of rate certainty for carriers). Therefore, assuming the FCC issues its new TELRIC rules later this year, a two-year grace period would allow the MDTE to maintain closely its existing March 2006 review schedule. Thus, the MDTE recommends that the FCC provide a two-year grace period for implementation of the FCC's new TELRIC rules for state commissions, such as the MDTE, that have adopted new UNE rates in 2003.

The MDTE further suggests that the FCC not require retroactive true-up of new UNE rates, as such a mechanism would create more uncertainty for both ILECs and CLECs over the UNE rates that apply in any given state. The new rates that state commissions develop from the FCC's new TELRIC rules should be applied prospectively, not retroactively to some arbitrary point in time (see NPRM at ¶ 151 where the FCC suggests true-up to the date of adoption of the new rules). If one of the goals of the new UNE rules is to promote sound investment decisions by providing the correct economic incentives for carriers, then the new rules should only be applied prospectively, where they can meaningfully influence carrier conduct.¹⁰

III. CONCLUSION

In closing, the MDTE urges the FCC to modify the existing TELRIC rules to set rates representative of ILECs' actual forward-looking incremental costs by taking into account the real-world attributes of an ILEC's existing network. These changes will improve the economic incentives for all carriers to invest in network facilities and will allow ILECs to recover the true cost of leasing UNEs. In addition, the MDTE recommends that the FCC give state

¹⁰ The FCC's proposed true-up mechanism can be distinguished from the one the MDTE approved in its most recent UNE rates case. The purpose of the true-up was to ensure that carriers would have the benefit of the rates that the MDTE had determined in July 2002, pending the resolution of compliance and reconsideration/clarification issues. The FCC, in contrast, would establish a true-up for yet-to-be-determined rates.

Reply Comments of the Massachusetts Department
of Telecommunications and Energy

commissions a measure of flexibility in implementing its new pricing rules to limit the
administrative burden on states and to provide certainty to both ILECs and CLECs.

Respectfully submitted,

Commonwealth of Massachusetts
Department of Telecommunications and Energy

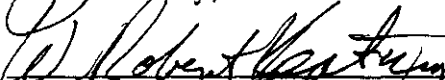
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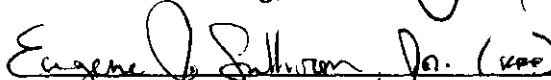
Paul G. Afonso, Chairman



James Connelly, Commissioner



W. Robert Keating, Commissioner



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January 30, 2004